



Haringey Council
Agenda item:

General Purposes Committee

On 28 June 2010

Report Title.	Treasury Management 2009/10 out-turn	
Report of:	Director of Corporate Resources	
Signed :	<i>J. Parker 16/6/10</i> Julie Parker	
Contact Officer :	Nicola Webb, Head of Finance: Treasury & Pensions Telephone 020 8489 3726	
Wards(s) affected: All	Report for: Key Decision	
1. Purpose of the report		
1.1	To report to members in accordance with the CIPFA Treasury Management Code of Practice and the Prudential Code on the following matters: <ul style="list-style-type: none">• details of capital financing, borrowing, debt rescheduling and investment transactions in 2009/10;• an assessment of the risk implications of treasury decisions and transactions;• details of the outturn position on treasury management transactions in 2009/10;• confirmation of compliance with treasury limits and Prudential Indicators.	
2. Recommendation		
2.1	That Members note the Treasury Management activity and performance during 2009/10 and compliance with treasury limits and Prudential Indicators.	

3. Reason for recommendation

- 3.1. To ensure members are aware of the Treasury Management activities undertaken during 2009/10 and to report on compliance with limits and performance.

4. Summary

- 4.1. This report sets out the Council's Treasury Management activity and performance during 2009/10 as required by the CIPFA Treasury Management Code of Practice.

5. Head of Legal Services Comments

- 5.1 The Head of Legal Services has been consulted on the content of this report and comments that its content and recommendation are within the policy agreed by Council and consistent with the purposes of Financial Regulations.

6. Use of appendices

- Appendix A – Summary of Prudential Indicators

7. Local Government (Access to Information) Act 1985

- 7.1 The following background papers were used in the preparation of this report:

- Financial Planning Report for 2009/10 to 2010/12 reported to Council and agreed on 23rd February 2009.
- Reports to General Purposes Committee dated 7 July 2009, 22 October 2009, 12 January 2010 and 29th March 2010.

For access to the background papers or any further information please contact Nicola Webb, Head of Finance: Treasury & Pensions, on 0208 489 3726.

8. Background

- 8.1 The CIPFA Treasury Management Code of Practice requires local authorities to determine an annual Treasury Management Strategy and now, as a minimum, formally report on their treasury activities and arrangements to full Council mid-year and after the year-end. These reports enable those tasked with implementing policies and undertaking transactions to demonstrate they have properly fulfilled their responsibilities, and enable those with ultimate responsibility for the treasury management function to scrutinise and assess its effectiveness and compliance with policies and objectives. The report reviewing the activity and performance in 2009/10 is to General Purposes Committee, Cabinet and full Council.
- 8.2 In November 2009 CIPFA released the revised Code of Practice for Treasury Management in the Public Services and accompanying Guidance Notes and the revised Prudential Code for Capital Finance in Local Authorities. The Communities and Local Government Department (CLG) also issued revised Guidance on Local Authority Investments for English authorities. The revised Codes and associated guidance re-emphasise an appropriate approach to risk management, particularly in relation to the security and liquidity of invested funds.
- 8.3 The Council is revising its treasury policy and practices documentation to take account of the requirements and changes in the revised Codes and Guidance.

9. Economic and treasury portfolio background in 2009/10

- 9.1 At the time of determining the Treasury Management Strategy Statement for 2009/10 in February 2009, globally economies faced a prolonged recession or period of weakness following the financial market meltdown in the autumn of 2008. The UK Bank Rate had been cut to 0.5% and the Bank of England had announced its initial £75bn of Quantitative Easing (QE). There remained a sizeable gap between the rates at which banks were willing to borrow from other banks and the Bank Rate, but this gap was forecast to narrow. Gilts were expected to benefit from QE, resulting in lower yields.
- 9.2 After the economic recession and severe downturn in growth that extended into early 2009, there were reports of an emerging recovery. In order to stimulate growth, the Bank of England maintained the Bank Rate at 0.5% throughout the year. The rates at which banks were willing to borrow from each other slowly moved lower towards the Bank Rate.
- 9.3 The Bank of England extended its Quantitative Easing (QE) programme from the initial £75bn to £200bn to revive the economy. UK Government Gilts were the main beneficiary of the economic downturn and as expected, they also formed the significant bulk of the QE purchases and are thought to have pushed gilt yields, and consequently the cost of borrowing, lower by 0.5%.

- 9.4 The position in the treasury portfolio at the end of the financial year compared to the previous financial year end is shown below. This shows the gross borrowing position is significantly higher than the net and the difference has reduced during 2009/10. The reason for this is a reduction in cash balances which has taken place through the year as internal cash balances have been used to fund the capital programme. The Council is holding pension fund monies in cash investments pending investment with external fund managers. These investments are shown separately in the table, as they are not available to the Council to spend. The sections below describe the activity on investments and borrowing and detail the reasons and risks associated with this position.

Treasury Portfolio	Position at 31/03/09 £000	Position at 31/03/10 £000
Long Term Borrowing PWLB	508,611	510,811
Long Term Borrowing Market	125,005	125,005
Short Term Borrowing	0	0
Long Term Liabilities*	4,240	44,322
Total External Debt (Gross Borrowing position)	524,856	680,138
Investments: Council	72,500	23,106
Investments: Pension Fund	18,850	33,967
Investments: Icelandic deposits in default	36,957	30,030
Total Investments	128,307	87,103
Net Borrowing position	396,549	593,035

* The 2009 SORP has resulted in the PFI related long term liabilities being brought onto the Council's Balance Sheet in 2009-10. The PFI scheme financing is covered by PFI credits from central government. The aggregate External Debt including PFI liabilities remained within above the Council's Prudential Borrowing Limit.

10. Long Term Borrowing

- 10.1 The Council's borrowing requirement for 2009/10 and that of two succeeding financial years was estimated in February 2009 to be £165,668k of which Unsupported Borrowing amounted to £15,234k. In addition £17,800k of loans were due to mature during 2009/10 and required re-financing.
- 10.2 The Prudential Code permits the Council the flexibility to bring forward or defer borrowing in relation to its Capital Financing Requirement. During the year the differential between debt costs and investment earnings was significant. In order to eliminate the high "cost of carry" associated with the higher cost of long term borrowing compared to temporary investment returns (between 0.5% and 1%), the

Council used internal resources in lieu of borrowing for the majority of the financial year. By doing so, the Council lowered overall treasury risk during the year. The Council recognised that utilising investments in lieu of borrowing clearly had a finite duration and when internal balances fell to a level which put liquidity at risk in March, £20m of borrowing was taken from the Public Works Loan Board (PWLB).

- 10.3 During the year PWLB borrowing rates were relatively “steep” (rates for short-dated maturity loans were much lower than for longer-dated maturities) reflecting the historically low Bank Rate of 0.5%. The cost of PWLB variable rate debt fell below 1%. During 2009/10 this significantly reduced the ‘cost of carry’ associated with the cost of new borrowing and income earned on investments. This was advocated as a borrowing option by the Council’s treasury management advisers taking into account the substantial proportion of fixed rate debt in the Council’s portfolio. Interest rates would undoubtedly rise over the medium term, but the increase in the cost of variable rate borrowing would be mitigated by a parallel increase in investment income earned at variable rates. Existing PWLB arrangements also permit the conversion of variable rate debt to fixed rate at minimal cost. Equal Instalments of Principal (EIP) loans also reflected the steepness exhibited in the borrowing curve and was advocated as a borrowing option by the Council’s treasury management advisers. EIP loan principal is repaid evenly over the life of the loan and thus avoids adding to specific peaks in the maturity profile of debt.
- 10.4 In the light of this, the additional borrowing taken by the Council in March 2010 was a £20m EIP loan with a variable rate which was 0.7% for the remaining few days of 2009/10. The Council will maintain the discipline to regularly review the proportion and cost of variable rate debt within the portfolio and will either repay or convert the debt to fixed rate as necessary.
- 10.5 Loans of £17.8m were due for repayment to the PWLB during 2009/10 and these were repaid on their due dates in June 2009. The Council has £125m loans which are LOBO loans (Lender’s Options Borrower’s Option) of which £75m of loans were in their option state in 2009/10. None of the lenders involved exercised any call options during 2009/10 and so the interest rates remained fixed.

The movements on the borrowing portfolio during 2009/10 are summarised below:

	Balance at 01/4/09 £000	Maturing loans £000	New Borrowing £000	Balance at 31/3/2010 £000
Fixed rate PWLB	508,611	(17,800)	0	490,811
Fixed rate Market	125,005	0	0	125,005
Variable rate PWLB	0	0	20,000	20,000
Variable rate Market	0	0	0	0
Temporary Borrowing	0	(184)	184	0
Total borrowing	633,616	(17,984)	20,184	635,816

- 10.6 The Council's borrowing costs were £44.82m against a budgeted cost of £46.4m. This is £1.58m lower than expected due to using internal balances in place of external borrowing. This underspend offsets the lower than anticipated income received in respect of investments – see section 11.7 below.
- 10.7 In all its borrowing activity, the Council complied with the prudential indicators set for 2009/10. All borrowing decisions, including the decision to use internal balances, were taken following advice from the Council's Treasury Management Advisor, Arlingclose Ltd.

11. Investments – activity and performance in 2009/10

- 11.1 The Council held average cash balances of £65m during the year for the Council itself and £34m on behalf of the Pension Fund. The Council balances represented working cash balances and the Council's reserves. The Council invested these funds in accordance with the Treasury Management Strategy Statement agreed for 2009/10. All investments made during the year complied with the Council's agreed Treasury Management Strategy, Prudential Indicators, Treasury Management Practices and prescribed limits. Maturing investments were repaid to the Council in full and in a timely manner.
- 11.2 The Council's investment priorities set out in the 2009/10 strategy were:
- 1) Security of the invested capital;
 - 2) Liquidity of the invested capital;
 - 3) An optimum yield which is commensurate with security and liquidity.
- The investments placed by the Council during 2009/10 reflected these priorities.
- 11.3 Financial markets remained in an uncertain state particularly at the beginning of 2009/10. Against this backdrop, the Council continued to place investments with a small, select list of counterparties and managing counterparty risk continued to be the Council's overwhelming investment priority. In addition to credit ratings, the Council has regularly reviewed other economic and financial information including

potential sovereign support, sovereign strength as evidenced by the ratings and GDP, sovereign and counterparty credit default swaps throughout the year.

- 11.4 The 2009/10 treasury management strategy determined 'specified' and 'non-specified' investments for use having assessed their risks and benefits in relation to the Council's particular circumstances, risk threshold and investment objectives. New 'specified' investments were restricted to the UK Government Debt Management Office, other local authorities, AAA-rated Money Market Funds and investments with banks and building societies which are Eligible Institutions under the UK Government's 2008 Credit Guarantee Scheme and with a long-term AA-(AA minus) Fitch rating. The 2009/10 treasury management strategy also included a number of 'non-specified' categories of investment – gilts, supranational bonds and deposits with any of the above specified counterparties for a period of more than one year. However none of the non-specified investments were used during 2009/10, due to the reduction in cash balances and the need to maintain liquidity.
- 11.5 At the beginning of the year the majority of investments were placed with the UK government Debt Management Office or on call with the UK banks on the Council's lending list. In November 2009, the Council started using AAA rated Money Market Funds following a selection exercise undertaken with the advice of Arlingclose, the Council's treasury management advisers. These actions enabled the Council to maintain the liquidity required, while earning a reasonable interest rate. From the table below, it can be seen that by the end of the financial year, all deposits with banks and building societies no longer on the lending list had been returned (with the exception of the Icelandic deposits – see 11.8 below).

	Balance at 01/4/2009 £000	Balance at 31/3/2010 £000
Debt Management Office	9,350	0
UK Banks and Building Societies on 2009/10 counterparty list	64,000	45,919
Banks and Building Societies not on 2009/10 counterparty list	18,000	0
Money Market Funds	0	11,154
TOTAL INVESTMENTS EXCLUDING ICELAND	91,350	57,073
Council investments	72,500	23,106
Pension Fund investments	18,850	33,967
Icelandic deposits in default	36,957	30,030
TOTAL INVESTMENTS	128,307	87,103

- 11.6 In order to monitor the credit worthiness of the investments the Council placed, the Council has been reporting a measure of credit worthiness produced by the treasury management advisers to General Purposes Committee on a quarterly basis. This measure scores credit risk on a scale of 0 to 10 on both a value weighted and a time weighted basis and the table below demonstrates how to interpret the scores:

Above target	AAA to AA+	Score 0 - 2
Target score	AA to A+	Score 3 - 5
Below target	Below A+	Score over 5

The scores reported throughout the year are shown in the table below and they demonstrate that the Council has remained within the target range throughout 2009/10:

	Quarter 1 30 June 09	Quarter 2 30 Sept 09	Quarter 3 31 Dec 09	Quarter 4 31 March 10
Value weighted	4.3	3.5	3.5	3.5
Time weighted	4.3	4.0	4.0	4.2

- 11.7 The UK Bank Rate was maintained at 0.5% throughout 2009/10. Money market rates soon fell to and remained at historic lows. Whilst existing investments provided some insulation against falling rates, new investments could only be made at the prevailing lower rates of interest. This has had a significant impact on investment income. The Council's investments achieved a return of 2.12% in the year and the income for the year was £1.58m. The 2009/10 budget for investment income was £2m following an allocation from reserves. This therefore resulted in an overspend of £0.42m, which was offset by the underspend on interest paid.
- 11.8 **Icelandic Investments** – the administration processes for the Icelandic banks in which the Council deposits are held are continuing. Three payments have been received by the Council in respect of the Heritable Bank deposits totalling £6,958k. This represents 35% of the original deposits. Legal challenges are continuing in Iceland with regard to whether local authority deposits in Landsbanki and Glitnir have priority status. The Landsbanki Winding Up Board determined that local authority deposits should have priority, but this is being challenged by the other creditors. The Glitnir Winding Up Board however decided that local authorities are not priority. This decision is being challenged by local authorities.

12. Short Term Borrowing during 2009/10

- 12.1 As discussed above, the cash balance of the Council was reducing during 2009/10 and as a result the Council was required to borrow funds on a short term basis at various points during the year. Due to the uneven pattern of the Council's cashflow, borrowing was required to meet the Council's obligations in advance of receipts being received. The table below provides a summary of the short term borrowing undertaken during 2009/10.

Lender	Number of occasions	Average amount borrowed	Average period of loan (days)	Weighted average interest rate paid
Other local authorities	12	£5.87m	1.83	0.34%
UK banks and building societies	21	£6.0m	2.68	0.50%
TOTAL	31	£5.95m	2.35	0.44%

13. Minimum Revenue Provision (MRP)

- 13.1 Local authorities are required to charge to their revenue account an annual provision for the repayment of debt associated with expenditure incurred on capital assets. This charge to the revenue account is referred to as the Minimum Revenue Provision (MRP).
- 13.2 The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 provide local authorities with a number of options as to how to calculate MRP. The Council's MRP policy for 2009/10 was approved by the Council. It was determined that the option which enables the Council to charge 4% of the Authority's underlying need to borrow would be adopted for Supported Borrowing. For unsupported borrowing the option to charge according to the life of the asset was agreed.

14. Compliance with Prudential Code indicators

- 14.1 The Council complied with the Balanced Budget requirement and as required by the Prudential Code, the Council approved a set of prudential indicators for 2009/10 on 23rd February 2009. The Council complied with all indicators during the financial year and details of each indicator are provided below with a summary set out in Appendix A.

14.2 Estimated and Actual Capital Expenditure

This indicator is set to ensure that the level of proposed investment in capital assets remains within sustainable limits and, in particular, to consider the impact on the Council Tax and in the case of the Housing Revenue Account (HRA), housing rent levels.

No. 1	Capital Expenditure	2009/10	2009/10	2009/10
		Estimated £000	Revised indicator £000	Outturn £000
	General	149,280	121,981	105,274
	HRA	49,725	60,479	60,638
	Total	199,005	182,460	165,912

Further information about the capital out-turn can be found in the 2009/10 budget out-turn report.

14.3 Estimated and Actual Ratio of Financing Costs to Net Revenue Stream

This is an indicator of affordability and demonstrates the revenue implications of capital investment decisions by highlighting the proportion of the revenue budget required to meet the borrowing costs associated with capital spending. The financing costs include existing and proposed capital commitments.

No. 2	Ratio of Financing Costs to Net Revenue Stream	2009/10	2009/10	2009/10
		Estimated %	Revised indicator %	Outturn %
	General	5.20	5.35	5.56
	HRA	33.59	32.77	27.67

14.4 Capital Financing Requirement

The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. In order to ensure that over the medium term net borrowing will only be for a capital purpose, the Council ensures that net external borrowing does not, except in the short term, exceed the CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years. The Council was within this limit throughout 2009/10.

No. 3	Capital Financing Requirement	31/3/10	31/3/10	31/3/10	31/3/11	31/3/12
		Estimated £000	Revised indicator £	Outturn £	Estimated £	Estimated £
	General	226,850	228,256	230,130	231,501	239,901
	HRA	449,242	449,331	452,765	492,498	542,731
	Total	676,092	677,587	682,895	723,999	782,632

14.5 **Authorised Limit**

This is the maximum amount of external debt that can be outstanding at one time during the financial year. The limit, which is expressed gross of investments, is consistent with the Council's existing commitments, proposals for capital expenditure and financing and with its approved treasury policy and strategy and also provides headroom over and above for unusual cash movements. This limit was set at £900m for 2009/10.

14.6 **Operational Boundary**

This is set to reflect the Council's best view of the most likely prudent (i.e. not worst case) levels of borrowing activity and is based on the Authorised Limit excluding the headroom for unusual cash movements. For 2009/10 the limit was set at £875m.

14.7 **Actual External Debt**

This indicator is obtained directly from the Council's balance sheet. It is the closing balance for actual gross borrowing plus other long-term liabilities. This Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

No. 4	Comparison of Actual External Debt to Authorised Limit and Operational Boundary	Authorised Limit £000	Operational Boundary £000	Actual External Debt at 31/03/10 £000
	Borrowing	895,419	870,419	635,816
	Other Long-term Liabilities	4,581	4,581	44,322
	Total	900,000	875,000	680,138

14.8 The levels of debt were measured on an ongoing basis during the year for compliance with the Authorised Limit and the Operational Boundary. The 2009 SORP has resulted in the PFI related long term liabilities being brought onto the Council's Balance Sheet in 2009-10 – this accounts for the large increase in long term liabilities. The PFI scheme financing is covered by PFI credits from central government. The Council maintained its total external borrowing and other long-term liabilities within both limits; at its peak this figure was £680,138k.

14.9 **Incremental Impact of Capital Investment Decisions**

This is an indicator of affordability that shows the impact of approved capital investment decisions on Council Tax and Housing Rent levels when the budget for the year was set.

No. 5	Incremental Impact of Capital Investment Decisions	2009/10 Revised £	2009/10 Actual £
	Increase in Band D Council tax	8.48	2.81
	Increase in average weekly housing rents	0.03	0.02

The table shows the difference between the revised indicators and the actual position was minimal on housing but slightly more significant on the General Fund.

This is a result of the out-turn on capital expenditure, which is covered in detail in the budget out-turn report.

14.10 Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure

These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. The exposures are calculated on a net basis, i.e. fixed rate debt net of fixed rate investments. The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on the portfolio of investments. The Council complied with these limits throughout 2009/10.

No.	Fixed and Variable rate exposures	2009/10 Estimated %	2009/10 Actual Peak Exposure %
6			
	Upper Limit for Fixed Rate Exposure	100	100
	Upper Limit for Variable Rate Exposure	40	4.33

14.11 Maturity Structure of Fixed Rate borrowing

This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates and is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years. It is calculated as the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate. The Council complied with these limits throughout 2009/10.

No. 7 Maturity structure of Fixed Rate Borrowing	Lower Limit %	Upper Limit %	Actual Borrowing as at 31/3/2010 £000	Percentage of total at 31/3/2010
under 12 months	0	25	52,005	8.2
12 months and within 2 years	0	25	46,500	7.3
2 years and within 5 years	0	50	111,743	17.6
5 years and within 10 years	0	75	109,475	17.2
10 years and over	0	100	316,088	49.7
Further split of long term borrowing				
10 years and within 20 years			59,088	9.3
20 years and within 30 years			25,000	3.9
30 years and within 40 years			10,000	1.6
40 years and within 50 years			147,000	23.1
50 years and above			75,000	11.8

14.12 Total principal sums invested for periods longer than 364 days

This indicator is set in order to allow the Council to manage the risk inherent in investments longer than 364 days. For 2009/10 this limit was set at £60m. However no investments were made for more than 364 days due to the reducing cash balances and the funding of capital from internal balances.

14.13 Adoption of the CIPFA Treasury Management Code

The Council originally adopted the CIPFA Code of Treasury Management in May 2002. At its meeting on 22nd February 2010 the Council adopted the revised CIPFA Code of Treasury Management. The Council has incorporated the changes from the revised CIPFA Code of Practice into its treasury policies, procedures and practices.

15. Other Treasury Issues

15.1 External Service Providers

Arlingclose is appointed as the Council's treasury management adviser. The Council is clear as to the services it expects and are provided under the contract. The service provision is comprehensively documented. The Council is also clear that overall responsibility for treasury management remains with the Council.

15.2 Training

CIPFA's revised Code requires the Chief Financial Officer to ensure that all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities. The CLG's revised Investment Guidance also recommends that a process is adopted for reviewing and addressing the needs of the authority's treasury management staff for training in investment management.

Training sessions were held in September 2009 and June 2010 for all councillors involved in decisions relating to treasury management. Treasury management staff have kept their knowledge up to date by attending training events arranged by the Council's treasury management advisors and CIPFA.

Appendix A

Summary of Prudential Indicators

No.	Prudential Indicator	2009/10 Revised Indicator		2009/10 Out turn
1	Capital Expenditure	£182,460k		£165,912k
2	Ratio of financing costs to net revenue stream			
	General Fund	5.35%		5.56%
	HRA	32.77%		27.67%
3	Capital Financing Requirement	£677,587k		£682,895k
4	Authorised Limit	£900,000k		£680,138k
	Operational Boundary	£875,000k		£680,138k
5	Incremental impact of capital investment decisions			
	Band D Council Tax	£8.48		£2.81
	Weekly Housing rents	£0.03		£0.02
6	Upper limit – fixed rate exposure	100%		100%
	Upper limit – variable rate exposure	40%		4.33%
7	Maturity structure of borrowing (U: upper, L: lower)	L	U	
	under 12 months	0%	25%	8.2%
	12 months and within 2 years	0%	25%	7.3%
	2 years and within 5 years	0%	50%	17.6%
	5 years and within 10 years	0%	75%	17.2%
	Over 10 years	0%	100%	49.7%
8	Sums invested for more than 364 days	£60,000k		£0
9	Adoption of CIPFA Treasury Management Code of Practice	√		√